

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 316

August 25, 1966

### SAVINGS AND LOAN ASSOCIATIONS: BAD DEBT RESERVE UNDER REGULATION 24348(a)

#### Syllabus:

Prior to 1960, taxpayer claimed bad debt losses on the specific charge-off method for California purposes. Since 1954, taxpayer used the reserve method for federal purposes. In 1960 and 1961, taxpayer's California returns reflected the use of the reserve method, but permission to change to this method had not been obtained from the Franchise Tax Board. In 1962, taxpayer's return reflected the use of the specific charge-off method. In 1963, taxpayer requested permission to adopt the reserve method and such permission was granted by the Franchise Tax Board.

Regulation 24348(a), effective during the years in question, allows an association to claim bad debt deductions on either the reserve or specific charge-off method. However, the Regulation also provides that once an election has been made, such election is binding until permission to change is obtained from the Franchise Tax Board. Further, where an association files its first return of income after December 31, 1958, the return itself is deemed a request to adopt the method reflected in the return. Where an association files its first return of income before December 31, 1958, such association must file an application requesting permission to change its method within 30 days of the close of the income year effected.

In the instant matter, the association taxpayer filed its first return of income several years prior to December 31, 1958. As such, if it desired to change its deduction method for 1960 or 1961, it could not do so by merely filing a return reflecting the use of such method. It could only do so by filing an application requesting permission to change within the time period prescribed by the Regulation. As taxpayer totally failed to file such request, the Regulation was not complied with and the purported change was totally ineffective.

It is not known whether taxpayer actually maintained proper books of account supporting the reserve method for 1960 or 1961. However, even if such were done, such fact should not be a material consideration in determining whether or not a taxpayer is entitled to claim deductions on the reserve method where permission has not been obtained. One of the primary purposes of Regulation 24348(a) is to prevent associations from switching from one deduction method to the other as their fancy deems fit. Thus, the Regulation requires an

association to use the method originally adopted for all subsequent years unless permission is granted in the manner prescribed. By such means the Franchise Tax Board retains effective control over the association in its deduction practices, and has a right to assume that the deduction method reflected in a return is authorized. If, on the other hand, an association could change its deduction method merely by keeping proper books of account it would be a relatively easy task to maintain books supporting both methods and then pick the method for each year resulting in a greater deduction. Such would in effect nullify the purpose of the Regulation.

It therefore follows that the permission requirement of the Regulation is vital and that if an association fails to obtain permission to change its method of bad debt deduction, the fact that it maintained books supporting such change is immaterial. Particularly should this be true in the instant matter where the taxpayer changed its method three times in four years.

Although taxpayer's deductions for bad debt losses based on the reserve method were properly disallowed, taxpayer is nonetheless entitled to bad debt deductions for the years in question based on the specific charge-off method to the extent such can be established. Regulation 24348(a) does not provide that an association loses the right to deduct bad debt losses if it fails to obtain permission to change its method. It provides only that an unauthorized method can not be used. Consequently, the taxpayer should be given the opportunity of establishing its 1960 and 1961 bad debts on the specific charge-off basis.